No. 89-1620

(8)

IN THE

Supreme Court of the United States

OCTOBER TERM, 1990

INDEPENDENT INSURANCE AGENTS OF AMERICA, INC., NATIONAL ASSOCIATION OF CASUALTY AND SURETY AGENTS, NATIONAL ASSOCIATION OF LIFE UNDERWRITERS, NATIONAL ASSOCIATION OF PROFESSIONAL INSURANCE AGENTS, NATIONAL ASSOCIATION OF SURETY BOND PRODUCERS, NEW YORK STATE ASSOCIATION OF LIFE UNDERWRITERS, INDEPENDENT INSURANCE AGENTS OF NEW YORK, INC., AND THE PROFESSIONAL INSURANCE AGENTS OF NEW YORK, INC.,

Petitioners,

v.

BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM,

Respondent,

MERCHANTS NATIONAL CORPORATION,

Intervenor.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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PETITIONERS' REPLY BRIEF

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August 13, 1990

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TABLE OF AUTHORITIES

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* Pursuant to Rule 28.1, the petitioners state that the National Association of Professional Insurance Agents, only, has a parent company, subsidiary (other than wholly-owned), or affiliate. That subsidiary is Certified Professional Insurance Agent, Inc.

1. That this petition presents questions of considerable national importance is demonstrated by the diverse amici briefs submitted to this Court. The insurance supervisory officials of the 50 states contend vigorously that the Second Circuit ruling undermines and obstructs their efforts to regulate the insurance industry in the public interest. *See Brief of the National Association of Insurance Commissioners as Amicus Curiae in Support of Petition for Writ of Certiorari* at 4. The state banking regulators of the 50 states contend, equally vigorously, that they are capable of overseeing the entry of a bank holding company's subsidiary bank into nonbanking businesses. *See Brief of the Conference of State Bank Supervisors as Amicus Curiae in Support of Respondent* at 2-3. The location of the federal-law boundary between these two classes of regulators is the exact question decided, wrongly, by the court below.

The ill-effects of the Second Circuit decision are not confined to insurance sales. The American Council of Life Insurance and the National Association of Realtors describe the adverse impact of bank holding company entry into the risky areas of insurance underwriting and real estate development. Indeed, bank involvement in real estate development, even when confined to traditional lending activities, already threatens the banking system. The value of leading bank stocks has fallen, "Sharp Retreat In Stock Prices Of Major Banks," American Banker, July 24, 1990, at 1; troubled real estate loans have cut bank earnings in the first quarter of 1990 by more than one billion dollars, "Problems with Real Estate Loans Held Back Earnings in 1st Quarter," American Banker, June 13, 1990, at 1, and continue to threaten the banking system with serious losses, *see* "Nonperformers, Foreclosures, Take Toll at Biggest Banks," American Banker, Aug. 7, 1990, at 8 ("The bottom fell out of the real estate portfolios of the nation's 10 largest banks in the first half of the year as the big banks racked up massive non-

performing loans . . . .") ; and bad real estate loans led to the federal takeover of the lead bank of a major—now bankrupt—Washington D.C. bank holding company, "Regulators Take Over D.C. Bank," Washington Post, Aug. 2, 1990, at 8.

The entry of bank holding companies into real estate development and other risky activities can only exacerbate the trouble. Even now, the Conference of State Bank Supervisors explains that five states allow insurance underwriting, twenty-four states permit real estate equity participation and development, and seventeen states authorize securities underwriting. Appendix 1, *Brief of the Conference of State Bank Supervisors as Amicus Curiae in Support of Respondent* at 2-3.

The practical importance of the question whether federally-regulated banking institutions can expand into a wide area of risky activities grows day-by-day. Since the petition for certiorari was filed, the Chairman of the Federal Deposit Insurance Corporation has admitted that the federal deposit insurance fund for commercial banks is under "considerable stress," and could lose as much as $2 billion by year's end. "Health of FDIC Being Exposed To the Spotlight," American Banker, July 25, 1990, at 1. Chairman Seidman's comments were made amid speculation that the FDIC is already insolvent. "Economist Says 'Insolvent' FDIC is Covering Up," American Banker, July 5, 1990, at 1.

Meanwhile, the S&L crisis deepens. The Government Accounting Office estimates that the clean-up could cost as much as $500 billion. "FSLIC Deficit Tops $87 Billion, RTC Costs Could Hit $500 Billion, GAO Says," Banking Report (BNA), p. 146 (July 23, 1990). And the evidence is clear that liberal state laws authorizing thrift entry into nonbanking areas, most notably real estate development, contributed directly to the current crisis. "For S&L Industry, Bailout Bill May Be A Fatal Blow," Los Angeles Times, Aug. 5, 1990, at A1.

Against this backdrop, the Solicitor General contends that an interpretation of the BHC Act permitting federally-regulated bank holding companies to enter non-banking businesses through liberal state banking laws raises no significant national issue. He relies on the fact that the Federal Deposit Insurance Corporation assertedly has authority that could be used to guard against the risks of bank expansion. But events have overtaken the Solicitor General's assurances. Since a new law to permit insurance activities was enacted in Delaware on May 30, 1990, Citicorp, the nation's largest bank holding company, has quickly taken steps to underwrite and sell insurance across the nation. "Citibank Comes to Kent County," Delaware State News, June 23, 1990, at 1. The FDIC is studying the problem, but has yet to take any action. "FDIC Appears Flexible on Insurance Issue," American Banker, June 18, 1990, at 1.

Had the petitioners' interpretation of the BHC Act been applied by the Second Circuit, today's situation would be drastically different. Because the BHC Act clearly and specifically bars general insurance activities, 12 U.S.C. § 1843(c)(8), application of the Act to bank holding companies in Delaware would have precluded the first stirrings of general insurance activity. There would have been no need, in other words, to hope that the FDIC would chase the horse after it escaped from the Federal Reserve Board's barn.

2. The Solicitor General acknowledges that the Second Circuit asserted the need to defer to the Board "before recounting an analysis of the Act's terms, structure, and legislative history," Brief for the Federal Respondent in Opposition at 12 n.10, but contends, nonetheless, that the Second Circuit applied the two-part *Chevron* standard in an unexceptional fashion. This Court's recent decisions demonstrate the error in that view. In *Maislin Industries v. Primary Steel, Inc.*, —— U.S. ——, 58 U.S.L.W. 4862, 4865 (U.S. June 19, 1990), the Court fully analyzed the

meaning of the relevant statute and, upon finding the meaning clear, refused to move past the first prong of the *Chevron* standard to grant the agency's plea for deferential review. In applying the first step, the Court was careful to note that the agency's interpretation "undermines the basic structure of the Act," and "conflicts directly with the core purposes of the Act." *Id.* at 4866. Similarly, in *Eli Lilly and Company v. Medtronic, Inc.*, —— U.S. ——, 58 U.S.L.W. 4838, 4840, 4842 (U.S. June 19, 1990), the Court looked closely at the structure of the relevant act and the plausibility of the proffered interpretation in order to determine the correct statutory meaning.

The failure of the Second Circuit to apply a similarly sophisticated approach was outcome determinative. That court found that (i) the Board's interpretation conflicts with the only identified statutory purpose, (App. A at 11a), (ii) the Board's major structural argument is "perplexing," (App. A at 14a), and (iii) the practical effect of the Board order is clothed with "apparent awkwardness and perhaps illogic," (App. A at 15a). Only because it deferred before it deliberated, by skipping the first step of the *Chevron* standard, was the court able to affirm the Board's interpretation.

3. The Solicitor General's attempt to defend the merits of the Board's interpretation largely rests on grounds rejected by the Second Circuit. The fact that Section 4(a) refers to "bank holding companies" and not to "banks," *Brief for the Federal Respondent in Opposition* at 13 & n.12, "somewhat begs the question, which is whether the limitation upon bank holding companies should be interpreted to restrict the activities those entities may engage in *indirectly* through their banking subsidiaries," App. A at 12a (emphasis in original). Moreover, notwithstanding the Solicitor General's assertion to the contrary, *Brief for the Federal Respondent in Opposition* at 13-14, the express insurance limitations of Section 4(c)(8) en-

tirely support "[t]he available inference . . . that subsidiary banks are subject to the 'activities clause' [of Section 4(a)] because they are within the category of entities exempted from that clause by section 4(c)(8)," App. A at 14a. The Solicitor General fails even to respond to the simple point that this Court has previously affirmed the Board's power to regulate the activities of subsidiary banks as part of its general power to regulate the nonbanking activities of a bank holding company. *See Board of Governors v. Investment Company Institute*, 450 U.S. 46, 59 n.25 (1981); *Petition* at 9 n.4 & 18 n.10.[1]

CONCLUSION

For the reasons stated herein and in their Petition, the petitioners respectfully request that the petition for a writ of certiorari be granted.

Respectfully submitted,

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[1] Merchants National Corporation and the Conference of State Bank Supervisors continue to advance interpretations of the Bank Holding Company Act that have been uniformly ignored by the Board, the Second Circuit and now the Solicitor General. They are entitled to no further weight by this Court.